APPENDIX A

Operating Agreement.

THIS INDENTURE, made this twenty-second day of February, one thousand eight hundred and ninety, by and between the CLEVELAND, CINCINNATI, CHICAGO AND ST. LOUIS RAILWAY COMPANY, party of the first part (hereinafter called the Cleveland Co.), and the PEORIA AND EASTERN RAILWAY COMPANY, party of the second part (hereinafter called the Peoria Co.), WITNESSETH:

WHEREAS the Peoria Co. has acquired a line of railroad extending westward from the boundary line between the States of Illinois and Indiana to Pekin, in the State of Illinois, together with rights and interests in the tracks and other property of the Peoria and Pekin Union Railway Company, hereinafter called the "Illinois part" of said line of railroad, and has also acquired a leasehold interest in a line of railroad extending from the boundary line between the States of Illinois and Indiana to the tracks of the Indianapolis Union Railway Company in or near Indianapolis, in the State of Indiana, with the right to use the tracks and certain other property of the Indianapolis Union Railway Company, hereinafter called the "Indiana part" of said line of railroad, and which said lines of railroad were formerly the property of the Ohio, Indiana and Western Railway Company, and which said "Illinois part" and "Indiana part" are subject to the lien of a certain mortgage to secure bonds known as Preferred Bonds of the Indiana, Bloomington and Western Railway Company for one million dollars, executed by said last named company on or about the 15th day of April, 1879, to the Central Trust Company of New York as trustee, and also subject to the lien upon said "Illinois part" and said "Indiana part," as well as upon the line of railroad extending from Indianapolis, Indiana, to Springfield, in the State of Ohio, formerly belonging to the

said Ohio, Indiana and Western Railway Company, for five hundred thousand dollars of preferred bonds secured by a mortgage executed by the Ohio, Indiana and Western Railway Company to the Central Trust Company of New York, as trustee, bearing date the second day of April, one thousand eight hundred and eighty-eight; and

WHEREAS the Peoria Co. has issued a certain series of its First Consolidated Mortgage Bonds, dated February 22d, 1890, for an aggregate amount of $10,000,000 payable on the first day of April, 1940, at its office or agency in the City of New York, with interest thereon from the first day of April, 1890, at the rate of four per cent. per annum, payable semi-annually at said office or agency in accordance with coupons for such interest annexed to said bonds, and has secured the payment of said bonds by a first mortgage of all its corporate property and franchises to the Central Trust Company of New York and Charles W. Fairbanks of Indianapolis as trustees, and which said first mortgage and said prior mortgages are superior to these presents; and is about to issue a certain series of its Income Mortgage Bonds dated February 22d, 1890, for an aggregate amount of $4,000,000, payable in 100 years, and bearing interest at not exceeding four per cent. per annum, and non-cumulative, payable when and only if, and to such extent, as earned, beginning April 1, 1891, and annually thereafter, out of the net earnings of the property, and is about to secure the payment of said last mentioned bonds by a second mortgage of all its corporate property and franchises, to said Central Trust Company of New York and Charles W. Fairbanks as trustees, and which said second mortgage shall be subject to these presents:

AND WHEREAS the railways of the parties hereto connect at Indianapolis, and it will be beneficial to the business and traffic of said railways that the same be put under one management:

NOW, THEREFORE, THESE PRESENTS WITNESS, that the Cleveland Co., in consideration of the premises, and of one dollar

to it in hand paid by the Peoria Co., the receipt whereof is hereby acknowledged, hereby contracts and arranges with the Peoria Co. for running the railroad of the Peoria Co. as follows:

FIRST.—The Peoria Co. hereby grants unto the Cleveland Co., its successors and assigns, subject to said first consolidated mortgage and to said prior mortgages, the right to use and operate that portion of its railroad known as the "Illinois part," and the Cleveland Co. agrees that it shall and will from henceforth and during the term herein limited, use, maintain and operate said "Illinois part" upon the terms and conditions herein prescribed; and the Peoria Co. hereby also assigns and transfers, subject to said first consolidated mortgage and said prior mortgages, for the period during which these presents shall continue, its leasehold interest in said "Indiana part," and all the rolling stock and equipment of the Peoria Co. and which said rolling stock and equipment shall be considered as included in said "Indiana part" whenever said "Indiana part" is herein mentioned or referred to; *and the Cleveland Co. shall and will henceforth and during the period of fifty years from April 1st, 1890, and for such further time thereafter as it may elect, use and operate said "Indiana part" and said "Illinois part"* as railways in such manner as to satisfy the requirements of law in the States and jurisdictions in which the same are or shall at any time be situated, *itself providing and furnishing at its own cost and expense, all other rolling stock and equipment, labor and supplies necessary for that purpose; and also at all times during its said use and operation thereof, also at its own cost and expense shall and will keep up and maintain all said "Indiana part" and said "Illinois part" of said line of railroad and all said rolling stock and equipment in good working order, and restore and renew all parts thereof as may be necessary to that end; and also shall and will pay all taxes on said "Indiana part" and said "Illinois part" of said line of railroad* or upon the earnings or income thereof, as well as rentals reserved, or other like charges, payable for such use in respect of any part or parts thereof; *and also shall and will*

indemnify and save harmless the Peoria Co. from any and all claims arising out of the operation or management thereof; and also at its own cost and expense shall and will do, perform and comply with all and singular the covenants, terms and conditions accepted or undertaken by the Peoria Co. in the conveyances, deeds and leases to it of the same or of any parts thereof, or in said mortgages so given by it to secure said bonds, excepting always the payment of the principal of said bonds, or of said prior bonds, it being understood and agreed that the Cleveland Co. does not assume the payment of such principal or any part of it.

SECOND.—The Cleveland Co. hereby covenants and agrees to and with the Peoria Co., its successors and assigns, and to and with all and singular the persons and parties who may at any time be or become the holders of the bonds secured by said first consolidated mortgage hereinbefore mentioned, or of any of them *that it shall and will provide for and make good any deficiency which may at any time occur in the fund necessary for the due and punctual payment as it accrues of the interest on the two series of bonds secured by the said prior mortgages hereinbefore mentioned and of the interest on all of the said First Consolidated Mortgage Bonds of the Peoria Co.* which may at any time be outstanding, and of any tax or taxes which the Peoria Co. may be required to pay or retain from said interest on any of said bonds (it being understood and agreed that said interest is to be paid without deduction for any such tax or taxes), after devoting to such payment of interest the net income which may arise from the purchase money lien of five millions of dollars on that part of the railroad formerly of the Ohio, Indiana and Western Railway Company between Indianapolis, Indiana, and Springfield, Ohio, and the net earnings derived from said "Indiana part" of said line of railroad and the net earnings derived from said "Illinois part" of said line of railroad; *and the Cleveland Co. guarantees that the net earnings and income from said three sources, so actually applied to the payment of said interest, shall not be less than four hundred and*

twelve thousand two hundred dollars in each and every year of the fifty years for which it by these presents undertakes the use and occupation of said "Indiana part" of said line of railroad; and it further agrees that such guaranty shall be increased by the sum of forty dollars in each and every year for each and every one thousand dollars of said First Consolidated Mortgage Bonds issued in excess of nine million four hundred and thirty thousand dollars; and that the Peoria Co. may transfer and assign the covenants contained in this second clause of these presents and all benefits thereof to the trustees of said mortgage executed by it as aforesaid to secure its said First Consolidated Mortgage Bonds, and that upon such transfer and assignment, said covenants shall be deemed and taken to be a direct and absolute obligation and guaranty of the Cleveland Co. to the said trustees and to all and singular the persons and parties, who may at any time be or become the holders of said First Consolidated Mortgage Bonds or of any of them, for the payment of all the interest to accrue thereon and on the bonds secured by said prior mortgages, as and when it shall become payable, and that the Cleveland Co. shall, if thereunto requested by the trustees of said First Consolidated Mortgage, execute and deliver to them and by way of further assurance, a separate and independent covenant and agreement to the effect hereinabove provided.

THIRD.—*The Cleveland Co. is to receive all earnings and income of the use and operation of said "Indiana part" and of said "Illinois part" of said line of railroad, and of said rolling stock and equipment*, and apply the net earnings of each year arising from the same (to be ascertained by deducting from the earnings and income of the year from its use and operation of said "Illinois part" and said "Indiana part," the expenses of operation and maintenance during such year, including taxes, assessments, insurance, rental and other like charges, and the cost of repairs, renewals and reasonable betterments to the said "Illinois part" and the said "Indiana part," necessary for their economical and efficient operation), together with the net income from the

purchase money lien of $5,000,000 on the part of the railroad formerly of the Ohio, Indiana and Western Railway Company between Indianapolis, Indiana, and Springfield, Ohio, to the payment of the interest as and when it shall mature and become payable upon the said two series of bonds, secured by prior mortgages upon said line of railroad, to wit: $1,000,000 of bonds issued by the Indiana, Bloomington and Western Railway Company and $500,000 of Preferred Bonds issued by the Ohio, Indiana and Western Railway Company, and to the payment of the interest as and when it shall become payable upon said First Consolidated Mortgage Bonds of the Peoria Co. After reimbursing itself out of what shall remain of such net earnings and income of the year, not applied as aforesaid to the payment of interest, for any advances hereunder in any previous year remaining unpaid to it (with interest thereon at the rate of six per cent. per annum), the Cleveland Co. shall apply the balance of said net earnings and income to the payment of interest upon said Income Mortgage Bonds according to the requirements of the mortgage securing the same, and pay over to the Peoria Co. any amount thereof finally remaining. It is understood and agreed that the Cleveland Co. is to be entitled to make the customary charge for the use of any and all additional rolling stock and equipment furnished by it as hereinbefore provided for use on said lines of railroad from time to time, and that such charge shall form part of and be included in the expense of operation hereunder.

FOURTH.—Within sixty days after the 31st of December, 1890, and each year thereafter, the Cleveland Co. is to make up and state all its receipts for earnings and income from the said lines of railroad operated by it under these presents, and from said purchase money lien, and all its disbursements for interest or rental as aforesaid, and for the cost and expense of using, operating and maintaining said lines of railroad and of complying with the requirements of these presents, and to render proper accounts thereof to the Peoria Co. and to the trustees of its said second mortgage as in said second mortgage required.

AND THESE PRESENTS FURTHER WITNESS THAT:

FIFTH.—*The Cleveland Co. shall and will look only to such future net earnings of said lines of railroad operated by it* under these presents and such future income of said purchase money lien, as shall not be required for the payment of said interest on said prior bonds and on said First Consolidated Mortgage Bonds, and hereinabove guaranteed by it, *for the reimbursement to it of any sums it may advance in compliance with its aforesaid covenants and agreements,* and the Peoria Co. hereby charges all such future net earnings and income coming to it, its successors or assigns, not required for the payment of said interest, with the payment of all such advances of the Cleveland Co., with interest upon said advances at the rate of six per cent. per annum.

SIXTH.—The Peoria Co. shall permit and suffer the use of its name by the Cleveland Co. in the use and operation of said lines of railroad, and in the acquisition of any and all property to be acquired for the purposes thereof.

SEVENTH.—Upon default by the Cleveland Co. in any act or thing by it to be done or performed under these presents, the Peoria Co., its successors or assigns, may resume the use and operation of its said lines of railway without prejudice to or impairment of the covenants and guaranty hereinabove expressed. All personal or real property paid for out of the earnings or income of the Peoria Co. is to become and remain its property, and the Cleveland Co. undertakes that whenever this present contract or arrangement shall terminate, it shall and will restore to the Peoria Co. rolling stock and equipment adapted for use on its lines of railroad of at least the value of the rolling stock and equipment leased to it by these presents.

IN WITNESS WHEREOF, said parties hereto have caused their respective corporate seals to be to these presents affixed, and the same to be signed by their respective presidents and secretaries the day and year first above written.

THE CLEVELAND, CINCINNATI, CHICAGO AND ST. LOUIS RAILWAY COMPANY,

[SEAL.] By M. E. INGALLS,
President.

Attest:
E. F. OSBORN,
Secretary.

THE PEORIA AND EASTERN RAILWAY CO.,

[SEAL.] By J. A. BARNARD,
President.

Attest:
W. W. LYNN,
Secretary.

Signed and delivered in the presence of (as to The Cleveland, Cincinnati, Chicago & St. Louis Railway Company):

JOSEPH MOSES,
F. H. LOVETT.

Signed and delivered in the presence of (as to The Peoria and Eastern Railway Company):

FRANK J. RICHMANN,
EDWARD C. RUMPLER.

APPENDIX B

Opinion of the Special Court.

DISTRICT COURT OF THE UNITED STATES,

FOR THE SOUTHERN DISTRICT OF NEW YORK.

WILLIAM CARNEGIE EWEN, and others,
Intervenors,
against
THE PEORIA & EASTERN RAILWAY COMPANY,
Petitioner.

DONALD N. GILBERT, and others,
Intervenors,
against
THE PEORIA & EASTERN RAILWAY COMPANY,
Petitioner.

Before:

L. HAND, Circuit Judge,
WOOLSEY and HULBERT, District Judges.

This cause comes on upon a hearing under §720 of the Bankruptcy Act, of a petition filed by the Peoria & Eastern Railway, for confirmation of a "plan of adjustment" filed under §710. Two committees of security holders have intervened under §720: that of Ewen and others, representing the "income bondholders"; and that of Gilbert and others, representing a minority of the first consolidated mortgage bondholders. Both object to confirmation, though not for the same reasons. The evidence was taken before a court con-

stituted under §713; and the case was later argued and submitted upon briefs.

JACOB ARONSON and CROSBY J. BEAKES, for the petitioner;

CHARLES S. ARONSTAM and ARCHIE S. KARP, for the income bondholders;

LOUIS G. BERNSTEIN, JULIUS J. ROSENBERG, LEONARD B. FRUTKIN and WILLIAM J. REINHART, JR., for the first mortgage bondholders.

L. HAND, C. J.: The facts are sufficiently stated in the report of the Interstate Commerce Commission, (March 27, 1940), passing upon the plan, and we shall accept it as the background for our discussion. The objections are chiefly because the plan disregards rights originally secured to the intervenors in the reorganization of the Ohio, Indiana & Western Railroad, a mortgage upon which was foreclosed in 1889. On the sale under the decree in that suit Coster and Spencer, who were acting for a committee of the old bondholders, bought in the property and effected a reorganization by a series of documents all dated February 22, 1890, implementing an earlier agreement of October 30, 1889. The general outline of the reorganization was that the Ohio, Indiana & Western Railway, which had been operating a road from Peoria, Illinois, to Springfield, Ohio, should be divided into two parts at the City of Indianapolis. The "Big Four" railroad—now controlled by the New York Central—bought in the eastern part in fee—which we shall call the Springfield Division—paying for it by giving to Coster and Spencer a lien upon it of $5,000,000, due on April 1, 1940, the principal of which it did not bind itself to pay, though it guaranteed the interest at four per cent. The western part of the road —which we shall call the Illinois-Indiana Division—Coster and Spencer conveyed to a new corporation, the Peoria & Eastern, the petitioner here. That is to say, they conveyed the fee of that part which was in Illinois, and they leased in perpetuity that part which was in Indiana, conveying the reversion later. (Why this curious device as to the Indiana

part was adopted, does not appear.) The petitioner paid for the Illinois-Indiana Division in bonds and shares of the new road, delivered to Coster and Spencer and by them presumably distributed among the old bondholders of the Ohio, Indiana & Western Railway. The "Big Four" bought half the shares and made an operating agreement with the new road by which it was granted the privilege of operating the Illinois-Indiana Division for fifty years, in consideration of which it was to pay all operating expenses, and the interest on the mortgages just issued to Coster & Spencer, as well as that on two mortgages already on the property, one for $500,000 which covered both divisions, and the other for $1,000,000 which covered only the Illinois-Indiana Division. The plan proposes to extend this agreement for twenty years beyond April 1, 1940, and the first question is whether the New York Central has the right to do so against the opposition of the intervenors.

1) The Extension of the Operating Agreement.

The first article of the operating agreement, so far as pertinent, read as follows: "the Cleveland Co. shall and will henceforth and during the period of fifty years from April 1st, 1890, and for such further time thereafter as it may elect, use and operate" the Illinois-Indiana Division. It is possible to construe these words, either as giving the "Big Four" a license to remain in possession for as long as it chose after the expiration of fifty years, or as giving it an option, to be exercised before the expiration of the term, to extend it for another fixed period. The first would result in a mere tenancy at will, terminable by either party, or from year to year, and the income bondholders might in that case be prejudiced by the proposed extension for a fixed term. Substantially similar words were construed in Western Transportation Co. v. Lansing, 49 N. Y. 499, as creating a tenancy at will, or from year to year, and the decision is the intervenors' main reliance. It is to be noted, however, that the court very particularly (p. 508) refused to pass upon whether, if the clause had created an option giving the lessee a privilege pending

the term to extend it for a new, though indefinite period, it would have been invalid; and the decision is therefore at most only an interpretation of the particular lease then before the court. It would not in any case be authoritative upon us, for the property at bar is in the States of Illinois and Indiana, where we have been unable to find any pertinent decisions; but it may be that in the case of an ordinary agricultural lease between individuals, like that there at bar, it is proper to interpret such a privilege as no more than a tenancy at will, or from year to year. On the other hand it seems to us quite inappropriate to adopt the same construction for an operating agreement between two railroads. The relation created involves elaborate and complicated operating adjustments, and to give either road a power to denounce it at will, or even at a year's notice, would put both in a position which, if not intolerable, would at least be extremely instable and unsatisfactory. We therefore construe the clause as giving the "Big Four" an option pending the term to extend it for a specified period in the future. (Whether more than one such extension was contemplated we need not decide.) The fact that the extension was left indefinite, and was to be fixed by the "Big Four", was immaterial; it has been law for over three hundred years that uncertainty in the length of a term at the time of the execution of a contract to grant it, is no objection, if its duration will become certain before it begins. Say v. Smith, 1 Plowden 269. The new term was here certainly for a "reasonable" period, assuming that such a condition was to be implied.

2) Prejudice to the Income Bondholders by the Extension.

What we have just said disposes of the argument that the extension could operate to the prejudice of income bondholders. Their bonds were made expressly subject to the agreement, and, if we are right, that included the power to extend the term. It is true that by so doing the New York Central will be able to recoup for its past advances out of future income, a privilege which would have otherwise ended on April 1st, 1940; but if that was what the agreement intended, no

wrong will be done. The suggestion that the original transaction is now subject to be reopened because the "Big Four" had bought half the Peoria & Eastern Railway's shares is without merit. In the first place, while the agreement was with the Peoria & Eastern, the transactions were in fact with Coster and Spencer, that is, with the old bondholders of the Ohio, Indiana and Western Railway, who presumably dealt with the "Big Four" at arms' length, who, as shareholders, were charged with knowledge of the whole transaction, and who were free to accept any conditions upon the income bonds that they chose. And that aside, we cannot understand how it can be seriously argued that after the lapse of fifty years, the contract should be unravelled, even if there had been substance in the objection at the outset.

3) The Payments Due under the Operating Agreement.

The third article of the agreement provided that the "Big Four" should receive all the income of the Peoria & Eastern Railway, deduct "the expenses of operation and maintenance", taxes and the like, and, out of the "net" income so resulting and any income from the $5,000,000 lien upon the Springfield Division, should pay all interest falling due upon the two prior mortgages and the first consolidated mortgage. If anything were then left, the "Big Four" was to reimburse itself "for any advances hereunder in any previous year remaining unpaid to it (with interest thereon at the rate of six per cent. per annum)", and finally to pay any balance, first to the income bondholders, and after them to the shareholders. This language is unequivocal; it appropriated each year's surplus, to all accumulated advances; the income bonds were to receive nothing until these were all paid. The second article of the agreement contains language which, however, both intervenors insist modified the meaning of the third, and fixed a minimum rental of $412,200, which the "Big Four" was bound to pay, regardless of any reduction in the interest due upon the three mortgages. The passage relied upon was in substance that the "Big Four" agreed that it would "make good any deficiency which may at any time

occur in the fund necessary" to pay the interest, "after devoting to such payment" the "net income" from the purchase-money lien on the Springfield Division, and "net earnings" of the two parts of the Illinois-Indiana Division. It guaranteed—and it is this language which is supposed to create a minimum rental—"that the net earnings and income from said three sources, so actually applied to the payment of said interest, shall not be less than four hundred and twelve thousand two hundred dollars" annually for the whole period of fifty years. (The guaranty included in addition forty dollars for each bond, issued by the Peoria & Eastern above the amount provided at the time, $9,430,000.) It appears to us clear that this was intended only as a guaranty that the income of the road should pay interest on all the bonds outstanding, just as the guaranty of the purchase money lien did that the income of the Springfield Division should pay interest on the lien itself. The text alone demands that conclusion, for the guaranty does not cover generally the net earnings and the income of the road, but only those earnings and that income, when "actually applied to the payment of interest". One cannot apply money in payment of interest upon a cancelled bond. (It is perhaps worth while also to note that the covenant runs not only to the Peoria & Eastern, but to the bondholders as well.) It is true that the "Big Four" got the advantage of operation of the division for no more than a guaranty of its fixed charges; and possibly the bargain was indirectly worth more than that to it, though the actual operation appears to have been at a loss. Be that as it may, if more than a guaranty of the fixed charges had been intended, the parties would surely not have fixed a rental—for in that event there would have been a rental—at such sum as $412,200. That was an absurd sum, unless they were thinking in terms of the fixed charges. Furthermore, if it was a rental, the supposed lessee would normally not have had a charge for any deficit in operation. Both articles seem to us therefore to be harmonious, and to provide that the income bondholders should get nothing except any surplus over all current charges, past and present.

4) The Accounts between the New York Central and the Peoria & Eastern.

Not only has a large operating deficit accumulated against the Peoria & Eastern, but a large "retirement" account and a large "depreciation" account have accumulated in its favor against the New York Central. The plan does not liquidate either of these, and the order of confirmation will leave open all questions touching their amount and validity. If the New York Central seeks in any year to withdraw any part of the earnings by way of recoupment, it must prove its right. All we now hold is that the covenant to maintain the road and to make additions to its equipment, did not contemplate gratuitous advances, and that the third article allowed recoupment for so much as was properly expended. Whether the cross items can be offset, the plan also leaves open.

5) The Use of $500,000 First Consolidated Mortgage Bonds as Security for the Peoria & Eastern's note.

The proceeds of a note of the Peoria & Eastern in favor of a subsidiary of the New York Central, were used to take up the $500,000 of prior bonds that were a lien upon both divisions of the road. The security for this note was $500,000 of the first consolidated bonds and 1730 shares of the Peoria & Pekin Union. The first question is whether the bonds were lawfully pledged under the mortgage, and that depends upon the seventh article. Fifteen hundred thousand dollars of the issue of ten millions was reserved to be issued "as may be necessary for the purposes of exchange for said prior bonds as hereinafter provided"; i. e., "when * * * the Railway Company shall deliver * * * to said Central Trust Company * * * any of said prior bonds * * * Central Trust Company shall issue to the Railway Company * * * an amount of said bonds so reserved equal at par to the amount of the said prior bonds so delivered at par". The argument is that the pledge was not such an exchange, and was therefore invalid. Even so, the lender would be entitled to be subrogated to the old bonds, paid by the borrowed proceeds. Subrogation is a purely equitable doctrine (Restatement of Restitu-

tion, §162); it disregards form, and here, the transaction would have been entirely regular if the following form had been adopted. The lender could have bought the old bonds, holding them without turning them in for cancellation. It could then have surrendered them to the Peoria & Eastern, which could in turn have surrendered them to the trustee of the mortgage in exchange for new bonds, par for par. The Peoria & Eastern could at the same time have delivered the shares of the Peoria & Pekin Union as additional security for any difference in value between the old and the new bonds, for the first consolidated bondholders could not have complained if the road had used its free assets to carry through such a transaction. Since all this would have been entirely lawful, and would not have impaired any rights of the bondholders, equity will effect the same result, even though the form chosen—i. e., a direct pledge of the bonds—was invalid.

The plan properly assumes, therefore, that the pledge was good; and deals with the note by treating $210,000 of the bonds as issued, and paying the remaining $290,000 at par out of the $5,000,000 by which the New York Central will cancel the lien on the Springfield Division. The lender must then release, not only the pledged bonds, but the 1730 shares of the Pekin & Peoria Union. The intervenor suggests that the bonds are now worth 60; if so, although no more than $174,000 should be allotted to the cancellation of the $290,000 of new bonds, the Peoria & Pekin Union shares will account for the balance, $116,000. It is true that the evidence of their value might be better, but it is reasonably apparent that there is nothing unfair in this part of the adjustment.

6) Contribution by the Springfield Division to the Illinois-Indiana Division.

The question as to this is whether the $500,000 prior mortgage upon both divisions should be wholly assumed by the Illinois-Indiana Division, or whether the Springfield Division should contribute ratably to its discharge. The deed of Coster and Spencer to the "Big Four", conveying the Springfield Division, was indeed without warranty, but the question whether a mortgagor who conveys part of the property means

to make the lien a primary incumbrance on what he retains, cannot be answered merely by recourse to the conveyances, or the order of their execution; it must be gathered from the implications of the particular transaction. The operating agreement required the net income from the purchase-money lien on the Springfield Division to be used to pay interest upon all three mortgages, the $500,000 mortgage among them, and therefore as to interest the Springfield Division was certainly not to contribute. The same intent appeared also as to the principal, because, although the first consolidated mortgage did not cover the Springfield Division at all, it provided that new bonds might be exchanged for the bonds of the $500,000 mortgage. Moreover, by the fifth article the Peoria & Eastern promised to "pay at the maturity thereof all principal of such of said prior bonds as shall not have been previously taken up by exchange". Since all the papers were parts of a single transaction and are to be read together, the mortgage was intended to be a burden on the Peoria & Eastern. The intervening first consolidated bondholders deny this; they explain the covenant as merely making it a default under the consolidated mortgage for the Peoria & Eastern not to pay the prior mortgages at their maturity. But if that was the only purpose, it did not require an assumption of the mortgages by the Peoria & Eastern; all that was necessary was to declare that default upon the prior mortgages should be a default upon theirs. Moreover, after any of the old bonds were exchanged for new the lien on the Springfield Division was on any theory pro tanto extinguished. Why should contribution exist only as to those that might not be exchanged? We can see no reason therefore for so circumscribing the significance of the covenant. In any event all these circumstances taken together satisfy us that the lien of the $500,000 prior mortgage was to be upon the Illinois-Indiana Division alone.

7) The Unfairness of the Plan to the First Consolidated Bondholders.

The first consolidated bondholders argue that the extension of the operating agreement is "unfair" within the doc-

trine of Case v. Los Angeles Lumber Products Co., 308 U. S. 106, because it allows the New York Central to recoup out of the income of the Peoria & Eastern properly applicable to the bonds, although the accumulated advances are a junior claim. This, as we have seen, is not a valid position in the mouth of the income bondholders because they took subject to an extension of the operating agreement; but that is not true as to the first consolidated bondholders, and the answer must depend upon other considerations. Under the plan the New York Central guarantees interest for twenty years on the remaining principal of the bonds, and their maturity is extended accordingly. Since this will take only $188,000, and the present estimated income of the road is about $304,000, at first blush the plan appears to create an unlawful priority in favor of junior claims. However, the situation is not so simple. If the plan fails of confirmation, the bondholders will, it is true, be able to foreclose upon the Illinois-Indiana Division immediately, but if they take it in, the debt against it will be not only the whole of the present first consolidated mortgage, but what is left of the prior lien bonds together with the note secured by the pledge. The New York Central probably will, and lawfully may, withdraw its deposit of $5,000,000, because the "Big Four" never undertook to pay the lien. That well may result in the foreclosure of the lien, and that in turn will subject the Springfield Division to the first consolidated mortgage since it covers the lien. But it is impossible now to say what in that event will be the net income of the two divisions, and how it will compare with the fixed charges. No present figures could throw any light upon that question, because the result would be a dismemberment of the system; for the New York Central could route its freight by other rails, and might do so, if the bondholders, being in possession of both divisions, would not come to terms. It is therefore not true to say that there is any assured income applicable to the first consolidated bonds upon foreclosure, which is to be used to pay junior debts. Acceptance of the plan was a question of judgment, which a majority of three-fifths might decide, §725 (2). In fact nearly four-fifths have decided for the plan, and the minority must accede.

9) Fulfillment of the Conditions Prescribed by §725 of the Bankruptcy Act.

It is clear that the situation is not proper for the radical reorganization provided by §77; nobody suggests, for example, that the Peoria & Eastern should be put into the hands of trustees, which that section would require. The road is temporarily embarrassed, but no more. On the other hand, if the plan goes through, there is ground for expectation that the road will be able to meet its debts; its chief difficulty has been the maturity of the first consolidated mortgage. If that can be refinanced as here provided, there is good prospect that the road can go on, and not only serve the public, but meet its debts, as they fall due. It is not likely to become insolvent, for its earnings are more than enough to meet its fixed charges; and, so far as we can see, no future financing will be necessary which will be beyond its powers. We recognize, of course, that these conclusions are conjectural, but that is inevitable. The important fact is that the plan fends off what might very well result in the disruption of an important part of a large transportation system, and does so with proper regard for the rights of all. We have tried to exercise that independent judgment which 1725 (3) requires of us, but it is impossible not to be influenced—e. g., as to the practicability of success—by the findings of the Commission. We do not understand, however, that in this we have been delinquent; quite the contrary, we ought to give great weight to its conclusions upon matters within its expert competence, even though in the end we are indeed charged with final responsibility for the result.

The last paragraph of §725 also requires us to approve the continuation of the existing voting rights in the Peoria & Eastern and in the way in which its directors and officers are selected. We must find that continuation "adequate, equitable, in the best interests of creditors and stockholders, and consistent with public policy". This we understand gives us a free hand in requiring the plan to give such representation as is equitable to the creditors. The income bondholders occupy much the same position as preferred share-

holders, and as such they have a very lively interest in the payment of the accumulated advances. We think that they should have representation upon the road's board of directors, so that they may continually keep advised of its affairs without the mediation of a court. We cannot, however, see any advantage in giving them more than one director, and certainly it would be extremely prejudicial to give them a majority, which is what they ask in case no income is paid on the bonds for two years. That might make joint operation difficult or impossible, and failure to pay interest on these bonds is not a default at all. All they need is some one who will have the absolute right to scrutinize the road's operation, management and finances. Hence we will modify the plan by virtue of the power given us in §721 so as to provide that the income bondholders shall have one director upon the board. This does not require resubmission to the Commission under §721 (a); nor does it substantially affect the interests of any class of creditors so as to require resubmission to any of these under §721 (b). The plan will therefore be modified to that extent and approved as modified.

The expenses of this proceeding are so moderate as to require no discussion.

The petitioner will submit proposed findings and conclusions and a proposed decree within five days after the filing of this opinion. The intervenors will file any supplements or amendments to these within five days thereafter.